

Economic Policy Review

December 2007

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Easing the administration of paying taxes for small companies

Adriana Mladenova

Last week the Budget and Finance Commission of the Parliament passed on second reading Draft of the Law on Corporate Income Taxation (LCIT). One of the proposed amendments is that companies with an annual turnover of less than 200,000 levs will not pay taxes in advance, as it is according to the currently applicable Law. The motivation behind this proposals are clear and logical “The change will lead to reduction of the burden of the taxpayers (which will save money and time) as well as reduction of the tax administration from the National Revenue Agency”.

Actually paying taxes in advance is a very bureaucratic procedure, which not only reduces the liquidity of the businesses but requires time and expenses. According to data provided by the Ministry of Finance, published in the mass media, the companies which will benefit from this amendment will be at least 164 000. To that number we should add the number of newly set up companies. According to the current Law companies which have become profitable during the previous year must make monthly advanced payments, while companies, which were at a loss, as well as newly set up companies must

make quarterly payments¹. If companies do not obey to the rules, they must pay interest on the sum of delayed taxes.

Cost-benefit Analysis

The benefits for business include:

- Time saved as a result of filling less payment forms and making less calculations. Although up to now not all companies observed this requirement, if we assume that 89% of the 164 000 companies have followed the requirements of the bill and on the average it takes them about half an hour to calculate the amount of the due taxes, to prepare the payment documents and to put them in the banks (some of the companies use Internet banking, which significantly simplifies the process), the time saved will be 590 thousand men-hours. In monetary terms, under these conservative assumptions, the costs saved will be at least **1,3 million levs**. For some companies the expenses related to tax payments are even higher than the usual, because they have to consult with experts and accountants. In order to estimate more accurately these costs it is necessary to perform a study among the companies.
- Costs saved from bank charges – they will be over **1 million levs**. The exact amount vary again according to the condition of

¹According to art. 84 and art. 85 from the LCIT.

the various banks and the number of companies which use Internet banking.

The benefits for the public sector include simplification of tax administration procedure. This may lead to optimization of administrative structure and savings of time and money. The exact calculations of these benefits also require more data and information from the public organizations themselves.

Expenditures of the budget

The budget will not lose the revenues from the advanced payments, there will only be a delay of receiving the funds. As the only loss one could account is the interest lost, which is calculated on the companies which have not paid in advance their dues. They are, however a very small amount and their role is not to generate revenues for the government, but to achieve an educational effect on the debtors. The largest revenue from corporate taxes the government receives in March, when the companies complete the accounting for the year and pay the remaining taxes. According to data provided by the Ministry of Finance during March 2007 they have received 524,8 million levs of revenue from corporate taxes, which is 35% of the revenues from corporate tax up to October, including. On the other hand the companies which fall into the range of less than 200 000 levs of annual turnover are 13% of the total number of active companies, according to BULSTAT.

It is clear that the benefits are much greater than the expenditures. Thus remains the logical question why the range had not been extended (as proposed by Martin Dimitrov from UDF for example, companies with an annual turnover of less than 1 million to be freed from advanced payments). According to the Law for Small and Medium Enterprises the companies with a turnover of less than 200 thousand levs fall into the category of micro- companies. These are companies with a turnover (or value of their assets) up to 3 900 000 levs., while the small companies are those with an annual turnover of up to 19,5 million levs.

According to an international study of the World Bank and PriceWaterhouse Coopers "Tax payments in 2008"² Bulgaria is at the 88th place

according to the general index for paying taxes, which takes into account the size of the tax rates, the number of tax payments and the time it takes to cover tax obligations, with respect only to the "time required to pay taxes" parameter Bulgaria is at the 160th place out of 176 countries., i.e. our country is at the bottom of the ratings in that category. It takes an average size company 616 man-hours to fill the required documents, collect and prepare the necessary data and at the end to pay its taxes. Part of the reason for that are the rather complex and difficult bureaucratic procedures, which unnecessarily burden the business and create work for the tax administration. For that reason the simplification of the administrative procedure of the tax payment process is very important and must undergo reviews together with size of the tax rates.

In this order, the reduction of the dividend tax from 7% to 5% is also a positive development, but more was possible as well. Dropping out the tax (according again to the proposal of Martin Dimitrov) will "cost" approximately 50 million levs, but against it there are costs of administration and costs for the business to calculate it and adhere to the regulations. With respect to simplifying the procedure of paying taxes there is a long way to go. We could apply some of the good practices of other countries – for example in Singapore it takes on the average 49 man hours for an average company to pay all its taxes, in Switzerland – 63 hours, Ireland – 76 hours (according to the study quoted above).

²The study is available here:
<http://www.doingbusiness.org/taxes>

Open Administration*

Svetla Kostadinova

Recent scandal between the Ministry of the Government Administration on one hand and non-government organizations and IT experts on the other brought out many questions. The decision of the Ministry to use and pay more than 51 million to Microsoft was questioned. The critics of this idea indicated that the decision to purchase licenses is not justified since it is possible to use free software like Open source by the State administration and thus save millions of leva.

The arguments of the Ministry were that the contract is already signed and there is nothing that could be done. The good thing is that it was understood that no further obligations would be undertaken and that the Ministry would be thinking about the use of open code if in the subsequent years it is proven that it is possible within the structure of the government administration. The opponents of the open source claim that its use will put the administration under greater risk and that such reform could not be done with such a large number of structures and people involved. However, it seems that this is not true. In a number of countries around the world separate agencies, ministries and municipalities are using open source operating systems and software.

According to the **Open book for free software**³ in **Germany** the Parliament took a decision to migrate towards operating system with open code at the beginning of 2002 because it would like to remain independent from single supplier and the subsequent lack of transparency, security and compatibility. The German armed forces forbade the use of Microsoft products in its structures due to actual and suspicion about possible problems with security. When **Mexico** announced that a migration of the education system is being planned to Linux, from Microsoft reacted immediately with a lot of free software, several free computers, a little bit of free technical support and a bit of entertainment

for the representative of the Mexican authorities. The migration towards Linux was delayed, but not for long.

In **France** the government agency ATICA supports the use of open software in the French public sector. In a special report to the French Prime Minister the agency provided an action plan, requirements for open standards and one of the six priorities is the use of open software in the public administration. **Denmark** installed in its education system StarOffice, and in addition the program was installed in the homes of the students. In **Spain** the Senate, The Council for Nuclear Security, the Ministry of Interior and the Ministry of Justice use server applications with open code. These examples, however, are only about separate public structures. Next year, for the first time, the entire administration of a European country will be using open code software. From **1st of January 2008 the Danish public** administration and offices will be required to use open standards for software. This is a result of lengthy negotiations and an agreement between the Danish central government, local municipalities and the Association of the Danish regions. Thus, Denmark will become the first country to introduce mandatory use of open standards on a national, regional and local level. The use of open standards is expected to increase competition on the software market, since the merchant would not be able to protect their market position (as it is in Bulgaria at present). The increased competition will reduce the prices of the products and services. This is a small part of the expected positive results.

The open standards allow interactions between different systems, solutions and organizations. In other words, each administration could use different software according to the specification of its activities and the possibility to negotiate lower prices with the various producers. This will save enormous amounts of money and time and is a very effective way to improve the compatibility of the public administration on the level of communications and exchange of data. This by itself has a result - improvement of the effectiveness of the public sector and guarantees a continuous flow of information from one system into another.

³ Authors are Vladimir Petkov and Elenko Elenkov. The book is published by Foundation „Applied research and communications” - www.arcfund.net/openbook.

Not least, in this way the people and the companies will have easier communications with the administration at lower costs.

During the discussion, surprisingly the Minister shared two arguments against, which do not sound logical. He said that it is possible that the people working in the administration may not like software with open code and for that reason not to use it. However, since our money is spend, which could be saved, this could not be a reason. Baring in mind the enormous positive effects from better communications within the administration, we will say that the software is not very different from the one used at present (quite the opposite), nor such an argument could justify spending budget funds. To avoid negative attitudes it will be necessary to train the administration, but this is relatively small initial cost, which will be compensated many times

over from positive effects and this is an opportunity for the government employees to improve their computer literacy. Very often the training takes couple of days and the users get accustomed to the new software within a month.

The other argument of the Minister was that he did not know about such software and for that reason he had not questioned the contract with Microsoft. Yes, it is probably not the job of a minister to know, but he must have experts, which must search for the best solution. As it is known – the lack of knowledge is not an excuse. Particularly for a Ministry..

* Short version of the article was published for the first time in the newspaper “Pari” on 12th December 2007.

Tax harmonization or tax competition*

Metodi V. Metodiev

During 1957 representatives of six European countries signed the Rome agreement, which establishes the European Economic Union. The Rome agreement foresees the elimination of commercial barriers between the participating countries. Together with that are established unified import duties, as well as common trade policy. To put it shortly, the main objective of the new union was to establish gradually homogeneous common (inter-European) market.

Fifty years after the creation of EC and almost sixteen years after the formation of EU with the Maastricht agreement now the member countries are 27.

The fundamental principals from time of the establishment of EC are the free movement of goods and services, labor and capital – and all that part of the vision of building a unified market.

During all the years of its existence EC succeeded to build a wall between internal Union economic policy and the same policy towards the rest of the World. At present on a European level a strongly protectionist trade policy is carried out and on the other – policy of

pressure to implement the ideas of the so called tax harmonization.

Generally, what is understood as tax harmonization could be defined as a process of standardizing the tax policies in the EC, directed against the countries outside the union and/or standardizing the tax policies inside community. Such policies include the tax rates themselves, as well as the tax regulations, which define the various types of procedures and channels for levying and collection.

The idea of tax harmonization became again the topic of the day after the joining of the 10 new member-countries to EU. Some of the old members felt threatened by the fact that the new member countries could offer better and more competitive conditions to business and as a result a large number of companies will swiftly switch to the new situation and could make decisions to move their businesses in a country providing better conditions for realization⁴.

Somewhere among the hundreds of different directives and policies of the EU among some economists (predominantly liberal) sneaks the idea for the so called tax competition. Simply said, this is implementing tax policies through market mechanisms, where the tax burden is

⁴ Naturally, we have to note, that a low tax burden is a significant part of health conditions for doing business in a given country

reduced significantly and reaches an optimal level. Competition effectively defines the working mechanisms of the free market not only for the private companies, but for the governments, which are forced to compete among themselves for “customers” (either corporate or private persons). Competition has the same effect on governments as that on the private businesses. Through the “invisible hand” of the market, the governments will be forced to become more effective and more responsive to the preferences of their “customers”. This will guarantee the right of choice of the separate company or individual between the various alternative policies and everybody will have the opportunity to make his objective choice on the basis of personally weighted net utilities whether to live and work in a given country or region. In addition, all of this will lead to implementing more precise budgetary policy in every country and/or region on both parts – revenue and expenditure.

Tax competition is an instrument to encourage people to elect its government based on easy to measure practical criteria and thus to a large extent overcomes “the deficit of democracy”,

which exists in the contemporary political systems. With his vote for a specific tax policy or disagreement with it and moving the business from one region to another, this will force the governments to face the consequences of the policies implemented, which at the end will save the taxpayer from becoming a victim of the system. All this is directly related to the fact, that with its introduction the contemporary tax systems are related to coercion. In other words, when the people are paying their taxes voluntarily one could be confident more of them will attempt to optimize the amount of money for them. In order to keep or attract new taxpayers (and) investors, the governments will have to offer innovative and more effective services to their “customers”. That is why it is said, that “competition is a very significant process of discovery and unsurpassed machine for growth” (Pierre Garelo).

* This article was published for the first time in the newspaper “Dnevnik” on 4th December 2007.

Economic Development is the Shortest Route to Happiness

Petar Ganey

The economics of happiness is one of the most modern trends in the current economic science and theory. This is an approach for valuation of prosperity, which combines techniques used by economist with those most frequently used by psychologists. While philosophers, psychologists and poets for centuries study and attempt to describe happiness, the economists recently entered this area. Some of the early economists and philosophers, starting with Aristotle and reaching to Bentham, Mill and Smith incorporated the **pursuit of happiness** in their work. However, with the development of economics as a science this remained on the backplane and prosperity was defined in a stricter manner, mainly associated with the economic results and the personal income.

Richard Easterlin (1974) is the first contemporary economist, which introduces the

connection between happiness and economic results. In his study Easterlin formulates what would later become known as the “**Easterlin paradox**”. In its simplest form, this paradox states that above a low level of income, economic growth does not improve human welfare. Or in other words, **money could not buy happiness!**

This claim provoked economists to look for new parameters for description and evaluation of human development and prosperity, which are different from the traditional. Income continuous to be important, however other categories come forward such as: social and family status, health, education, working conditions, culture, etc. The development in this area of economics begins to have greater effect on various public policies, such as public finance (government expenditure and taxes), social policies and labor markets.

All this however, is based on the idea that we could measure and hence provoke happiness. Such claim however is more than wrong – it is immoral.

In order to define the link between economics and happiness, either by Easterlin or any other economist, it is necessary first to measure happiness in various countries at various periods of time. This measurements has always been made in the following manner – through questionnaires given to a large group of people, which individually determine the level of their own happiness, for example on a scale from 1 to 10. Is it possible however, such an exercise to provide satisfactory and close to the actual result? It is unlikely that someone would ever fairly say such words as “*I am happy around 7*”. The quantitative measurement of happiness is a senseless exercise. People cry and smile every day and in the best case could evaluate their current state and claim that they are happier compared to a previous period.

All of this is placing a significant doubt on the contemporary economic approach to happiness. This approach is fundamentally different from the more philosophical view of the early philosopher-economists. Smith, Bentham and Lock study “the pursuit of happiness”, not the happiness itself. Actually, Bentham and not Thomas Jefferson, is the cause “the pursuit of happiness” to be part of the Declaration of Independence on the same level as the right of live and liberty. While happiness itself is not directly related to economic results, the pursuit of happiness plays an important role in the development of every society.

In order to show clearly the connection pursuit of *happiness – human development – happiness*, we have to define first the measurements of human development. In general, they could be classified in seven categories: human rights, environment, management, economic growth, education, health and culture. These seven scales of development however have different value when we are talking about the goals of development and the means for that development. Actually in this division is hidden the difference between the “pursuit of happiness” and “happiness”. Happiness is associated with the goals of development, while the pursuit of happiness provokes the means for such development.

Hans Rosling (2006) makes an attempt to distinguish the different measures of human

happiness by indicating which are more means and which are actually the goals of the development:

	Means	Goals
Human rights	+	+++
Environment	+	++
Management	++	+
Economic growth	+++	0
Education	++	+
Health	+	++
Culture	+	+++

Naturally the economic growth is the most important means for development and the strongest manifestation of the “pursuit of happiness”. Actually the growth allowed to a very large number of people around the World to avoid the trap of poverty and to live better. That means that life is something more than an attempt to survive. It is not possible to talk about any happiness if people are fighting for their food every day. Money may not buy happiness, but they certainly could buy food, shelter and medication. On the other hand, the main goals of development are human rights and cultural development. Culture is the most important thing in life, since it is what brings joy to life. Culture and human rights however are way above economic growth.

This is the main difference in the approach of the early and contemporary economists to happiness. More than two centuries ago the economists focused on the relation pursuit of happiness – economic results. Today the focus is entirely on the relation economic result – happiness. The “Easterlin paradox” itself shows, that the economists which have attempted to explain economics purely philosophically and have avoided complex models and quantitative indicators, have been able to find the true relation between happiness (pursuit of it) and the economic consequences.

Legislation during December

Veliko Dimitrov

Traditionally during December, as well as during the previous month of November the representatives work harder – the number of proposed bills is higher, the debates are more active, sometimes even extraordinary meeting are called. Annually, in the Parliament are introduced around 300 – 350 bills, or between 25 and 30 every month. During the last two months of every year the proposed bills are more than the monthly average, there are also more proposals for changes between the first and second readings of the bills. This higher activity of the Parliament is not by chance and is due to two very important reasons: firstly, at the end of each year the tax framework for the next 12 months is voted and secondly, at the same time it is decided how and how much to spend of the budget surplus. The decisions of the Parliament for December are basically the following:

1. Preserving the taxation on gambling activities from toto and lotto, betting on the results from sport events and random events.

The Members of the Parliament (MP) rejected the proposal of the Council of Ministers to change the taxation basis and the way taxes are paid on the above mentioned gambling activities. Deferring from the bills entered by the opposition, it is an extremely rare event that a bill proposed by the cabinet is rejected by the Parliament. This time it happened under very strong pressure from society and also since neither party from the ruling coalition would not take responsibility that it was the initiator of that bill (however the proposal initially was approved by the Cabinet, i. e. there has been a consensus). When we talk about taxing gambling in Bulgaria we must mention the fact that gambling activities with mechanical means, i.e. casinos, get a significant preferential treatment not only as compared with the other gambling activities, but also as compared to all other economic activities - taxes are levied on the number of gambling machines rather than financial results. Like every other year, however the MP's could not correct this "omission".

2. The currently cheaper cigarettes will become relatively more expensive from the beginning of next year.

Between the first and the second reading of the bill on Excise duty and tax warehouses the MP's changed the taxation of cigarettes. Starting 1st of January 2008 the specific excise duty is increased to 37 leva per 1000 cigarettes (currently 6,50 leva), while the proportional excise duty is reduced from 54% to 35% from the sales price. The initially passed proposal by the Ministry of Finance was that the specific duty is raised to 14,5 lev, while the proportional is kept the same. Both proposals would lead to higher prices of cigarettes begging from the New Year, however with the second the cheaper brand cigarettes will become relatively more expensive, since the increase in duty per one cigarette as compared to their selling price is higher, than of the more expensive class. Only cigarettes with a current price above 5 leva for a pack of 20 cigarettes could become cheaper if the producer or importer price remains the same. The most popular Bulgarian cigarettes "Victory" would sell at about 2,90 – 3,00 leva.

3. Changes in the Value Added Tax Bill foresee levying VAT on legal and notary activities as well as on the private enforcement agents

Levying taxes must be led by the principle of neutrality and equality. If all other activities are levied VAT, than it is logical that similar duty applies to notaries and lawyers, whose services are a result from independent economic activity, but are also services which represent added value. The need for VAT on the services provided by the private enforcement is questionable since there are still the state enforcement agents, on whose services no VAT would be levied. In that sense, according to representatives from the opposition, competition will be tilted because both state and private enforcement agents must operate with the same tariffs. Still it is not very likely that there is going to be a mass migration in search of state enforcement agents simply because the stimuli for more effective work and faster return of the dues of their customers their are completely non existent. Here is the time to ask, however, the following question: since already for two years the institution of private enforcement agents operates very well (even government institutions use the services of the private enforcement agents instead of the government enforcement) why not move to entirely private enforcement rather than a mixed system? Than the differences of VAT treatment will be resolved by themselves.

4. The opposition (UDF) entered a proposal for quicker return of the VAT “to the good” merchants - less than ten days

According to the MP's making the proposal, good merchants should be considered those, which during the last three VAT audits the difference between the actual and declared obligations is less than 3% or insignificant. The idea and the initiative for quick return of the funds to the law obeying companies is naturally very positive. Probably a small change would make it even better: VAT is returned quickly to companies, which have no financial violations. And if in principal the quick return works, than the tax must be returned faster to all merchants, since if there are violations there would be sanctions.

5. With 55 votes “yes” and 57 votes “against” (21 “abstention”) the Parliament rejected on first reading the bill for prevention of personal benefits from office (proposed by Philip Dimitrov – UDF and a group of MPs)

There two lines along which one can argue: the MPs either do not see anything wrong with corruption, as well as hiding conflicts of interest or believe that such a bill is not likely to resolve the problem. If the second claim is true, than it is a direct recognition that apparently the laws are violated, when we talk about corruption, and in addition it is at the high levels of power.

6. “Interesting” idea of the Ministry of Agriculture and Food Supplies – Agency and a Bill for Consolidation.

The idea is not new, similar “solutions of some problems” were promoted by the previous Minister of Agriculture, in 2001 even a bill was proposed for consolidation of the agricultural land. In all cases, however, the reality 6 years ago does not compare to the situation today – investment funds and private companies are buying land and consolidating it, farmers set up cooperatives and get the economies of scale, et

set. Something else is more important – the ideas of minister Nihat Kabil are more related to taking over the private agri-business and in some sense nationalize the land and probably subsequent sale of it, than a simple consolidation of separate lots. What apparently wants the State as represented by the Ministry of Agriculture is almost the same as what was done by one company and because of it the Parliament very quickly changed the Insurance Codex. Namely, to allow retired people to sell their land, but instead of getting cash, the state will give them additional pensions. Now, is it necessary that the State will become an insurance company?

7. The big spending

May be the most heated debates during the month were related to how and how much funds to spend from the budget surplus. According to the Law on Budget, the Government could spend this year approximately 300 million leva from the surplus (1,5% from the planned expenditure in the consolidated budget) without having to ask the Parliament. Initially the Council of Ministers made a proposal for additional 570 million leva or a total of over one billion leva. Very soon after, at one of the meetings of the budget commission, minister Oresharski requested instead of 570 million, 700 million, since the surplus of the revenues in the budget is greater than expected. During the discussions in the Parliament, the deputy chairman of the RFP Mr. Yordan Tzonev increased the requirement from 700 to 900 million leva, since “the situation had shown new opportunities”. The main part of the funds will be spent on infrastructure projects and to cover additional payments for disasters around the country. Taking into account the situation, the voting according to party lines of most proposed bills, we could say that to some extent the Parliament registers the decisions of the Government, unfortunately there is no progress in that respect in this area.

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